No. 06-560

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IN THE

Supreme Court of the United States

AVIS BUDGET GROUP, INC., FKA, CENDANT CORPORATION, TIME WARNER INC., RICHARD A. SMITH, DAVID COLBURN AND ERIC KELLER,

Petitioners,

v.

CALIFORNIA STATE TEACHERS RETIREMENT SYSTEM,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF

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STATEMENT PURSUANT TO RULE 29.6

The corporate disclosure statement of Petitioner Avis Budget Group, Inc., formerly known as Cendant Corporation ("Cendant"), was set forth on page ii of its Petition for a Writ of Certiorari ("Petition"), and there are no amendments to that statement.

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Respondent does not dispute that the question presented in the Petition involves an important and recurring issue of federal statutory law. Instead, Respondent focuses primarily on the underlying merits of the issues by arguing that the decision below comports with this Court's precedents. Petitioners[1] will not burden the Court with a repetition of how the decision below simply cannot be reconciled with this Court's precedents governing primary liability under Section 10(b) (*see* Petition at 14-18), a topic which is more appropriately addressed if certiorari is granted. Rather, this reply primarily addresses the two issues raised in opposition that more directly relate to whether certiorari is appropriate and warranted: (i) whether the issues raised by the Petition are now "moot" as a result of further proceedings that have occurred in the District Court, and (ii) whether there exists a real and deep conflict among the Circuit Courts warranting this Court's review.

I. *The Issues Presented in the Petition Are Not Moot*

In the decision below, the Ninth Circuit remanded this matter to the District Court to allow Respondent the opportunity to seek leave to amend its complaint in a manner which might satisfy the Ninth Circuit's newly-articulated standards for "scheme" liability against secondary actors such as Petitioners. On remand, the District Court entered an order on December 18, 2006 denying Respondent's motion for leave to amend as against Petitioners, concluding that amendment would be futile because the proposed second amended complaint ("SAC") failed to allege any facts that could establish primary Section 10(b) liability under the Purpose and Effects Test[2] adopted by the Ninth Circuit in

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[1] Time Warner Inc., David Colburn, and Eric Keller are no longer petitioners because they reached a settlement with Respondent after the Petition was filed.

[2] Capitalized terms herein not otherwise defined have the meanings ascribed to them in the Petition.

the decision below ("Order on Remand"). Respondent filed a Notice of Appeal from the Order on Remand in the Ninth Circuit on January 18, 2007.

According to Respondent, the Petition is now "moot" because Petitioners — by virtue of the Order on Remand — are not parties to the action and have no "legal interest" in this Court's review of the issues raised in the Petition. (*See* Resp. Br. at 11). As both a matter of logic and law, however, Respondent is wrong.

A case becomes "moot" only when "'the issues presented are no longer 'live' or the parties lack a legally cognizable interest in the outcome.'" *City of Erie v. Pap's A.M.*, 529 U.S. 277, 287 (2000) (citation omitted). Put differently, a case becomes moot when "an event occurs while a case is pending on appeal that makes it *impossible* for the court to grant 'any effectual relief whatever' to a prevailing party." *Church of Scientology of California v. United States*, 506 U.S. 9, 12 (1992) (quoting *Mills v. Green*, 159 U.S. 651, 653 (1895)) (emphasis added).

Here, Respondent has appealed from the Order on Remand, in which the District Court concluded that the SAC failed to allege facts that could establish primary Section 10(b) liability against Petitioners under the very standards for "scheme" liability that are at issue in the Petition, and which the Ninth Circuit articulated for the first time in the decision below. Thus, in order to resolve Respondent's appeal, the Ninth Circuit will again apply these new legal standards, which Petitioners submit are inconsistent with this Court's precedent and in conflict with the approach of *four* other Circuit Courts. As with any appeal, there is a possibility that the Ninth Circuit could reverse the District Court's findings, and conclude that the SAC *does* state a claim against Petitioners under the legally-defective standards for liability

established below. Against this backdrop, it simply is inaccurate, as Respondent contends, that the issues raised by the Petition are no longer "live" or that Petitioners lack any "legal interest" in this Court granting certiorari.

It also is quite clear that this Court could grant "effectual relief" to Petitioners were it to grant certiorari. In *In re Charter Communications, Inc. Securities Litigation*, 443 F.3d 987 (8th Cir. 2006), *petition for cert. pending*, (No. 06-43), which directly conflicts with the decision below (*see* Petition at 11-13 & Point II, below), the Eighth Circuit correctly applied *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994), and held that "any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under Section 10(b) or any subpart of Rule 10b-5." *Charter*, 443 F.3d at 992. Here, Petitioners were not alleged to have made, or to have participated in the making of, any of the false and misleading statements or omissions challenged in the litigation below (or to have engaged in any act of "manipulation"). Therefore, under the Eighth Circuit's holding in *Charter*, Petitioners could not be primarily liable under Section 10(b) as a matter of law.

The litigation and pending appeal against Petitioners would necessarily be decided finally in their favor if this Court were to grant certiorari and conclude that the Eighth Circuit's approach to "scheme" liability is correct. Because a grant of certiorari can result in such effectual relief, the issues raised by the Petition are by no means "moot."

II. *There is a Real and Deep Circuit Conflict Meriting This Court's Review*

Respondent also contends that there is no "practical" conflict between the decision below and *Charter*, and that the decision below also does not conflict with any other Circuit's approach. As demonstrated in the Petition, however, the conflict between the decision below and *Charter* — as well as every other Circuit Court that has considered the circumstances under which secondary actors may be primarily liable under Section 10(b) in the wake of *Central Bank* — could not be any more direct. (*See* Petition at 11-14).

Indeed, the plaintiffs in *Charter* pursued precisely the same "scheme" theory of liability Respondent has pursued here, and sought to hold non-speaking secondary actors primarily liable under Section 10(b) for allegedly entering into "sham transactions" with the issuer "knowing" that the issuer intended to later account for them improperly. *See Charter*, 443 F.3d at 989-990. The Eighth Circuit squarely rejected plaintiffs' Rule 10b-5 "scheme" theory of liability as an attempt to circumvent *Central Bank* and held that "any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under Section 10(b) *or any subpart* of Rule 10b-5." *Id.* at 992 (emphasis added).

In direct contrast, the Ninth Circuit held below that a secondary actor may be primarily liable under Section 10(b) for engaging in a "scheme to defraud" consistent with *Central Bank*, even if it did not make any of the challenged misstatements or omissions, so long as it engaged in conduct

that satisfies the newly-articulated Purpose and Effects Test.[3] Thus, pursuant to the standards articulated by the Ninth Circuit, secondary actors can be primarily liable for securities fraud under a "scheme" theory of liability for engaging in conduct *short of actually making a misstatement or omission.* Accordingly, it is difficult — if not impossible — to understand how this decision is *not* in conflict with *Charter*, in which the Eighth Circuit expressly and unequivocally held that a secondary actor must actually make a misstatement or omission to be liable under Section 10(b), and that anything less is nothing more than "aiding and abetting."[4]

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[3] According to the decision below, as well as *Charter*, a secondary actor could also be primarily liable for engaging in an act of "manipulation," as that term of art has been defined by this Court. However, there was no contention in *Charter*, or here, that the secondary-actor defendants engaged in any such conduct.

[4] No doubt in light of this obvious and direct conflict, Respondent also argues that, despite differing legal "standards," the Eighth and Ninth Circuits approaches do not matter in "practical effect." (*See* Resp. Br. at 21). Respondent is mistaken. In holding that Respondent's allegations failed to satisfy the Purpose and Effects Test, the Ninth Circuit reasoned below, *inter alia*, that Respondent did not adequately allege that the transactions at issue were "sham" or "illegitimate" transactions from the time that they were entered into. *See* Pet. App. at 26a-28a (petitioners "may not be held liable for participating in *legitimate* transactions that became 'deceptive' only when distorted by the willful or intentional fraud of another party.") (emphasis added)). In contrast, in *Charter*, the plaintiffs had alleged that the transactions entered into by the secondary actors were in fact "sham" transactions from the beginning, and yet the Eighth Circuit held, as a matter of law, that such actors could not, in any event, be held primarily liable under Section 10(b) because they were not alleged to have made any of the challenged misstatements or omissions. *See Charter*, 443 F.3d at 992. Thus, the decisions conflict as a matter of "practical effect," because entering into a business transaction perceived as "illegitimate" could result in liability for a non-speaking secondary actor under the Ninth Circuit's Purpose and Effects Test, but could at most be "aiding and abetting" under the Eighth Circuit's approach in *Charter*.

Moreover, as established in the Petition, the Ninth Circuit's newly-articulated standards for "scheme" liability also conflict with three other Circuit Courts which have held that, in light of *Central Bank*, a secondary actor cannot be primarily liable under Section 10(b) if it did not actually make any of the challenged misstatements or omissions or engage in any acts of manipulation. *See, e.g.*, *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997) ("'If *Central Bank* is to have any real meaning, a defendant must actually make a false or misleading statement . . . [a]nything short of such conduct is merely aiding and abetting . . . .'") (citation omitted); *Anixter v. Home-Stake Prod. Co.*, 77 F.3d 1215, 1226 (10th Cir. 1996) (same); *Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1205 (11th Cir. 2001) (same). (*See also* Petition at 13-14).

According to Respondent, these decisions are not truly in conflict with the decision below because they addressed subsection (b) of Rule 10b-5, whereas "scheme" liability implicates subsections (a) & (c) of Rule 10b-5. (*See* Resp. Br. at 18). But contrary to Respondent's assertion, these Circuit Court holdings are not limited to Rule 10b-5(b); rather, they clearly resolve the broader question of the scope of liability for secondary actors under Section 10(b) itself. *See, e.g.*, *Shapiro*, 123 F.3d at 720 ("'a defendant must actually make a false or misleading statement in order to be held liable under *Section 10(b)*'") (citation omitted) (emphasis added)); *accord Anixter*, 77 F.3d at 1226; *Ziemba*, 256 F.3d at 1205. Respondent's purported "distinction" also is irrelevant in light of this Court's repeated recognition that subsections (a) and (c) of Rule 10b-5 cannot create liability for conduct that is not prohibited under Section 10(b), the Rule's enabling statute. (*See* Petition at 15 (citing cases)).

Finally, despite the Circuit conflict and continuing debate over whether, consistent with precedents of this Court,

secondary actors can be liable for engaging in a "scheme to defraud" without making a misstatement or omission, Respondent contends that review of the decision below is not warranted in any event because it imposes a "high hurdle" for "scheme" liability against secondary actors. (*See* Resp. Br. at 29). In this regard, Respondent relies primarily on the fact that leave to amend was denied as against Petitioners in the Order on Remand. The result reached in the Order on Remand, however, in no way undermines the compelling reasons why this Court should grant certiorari and resolve the Circuit conflict now.

To begin with, in the Order on Remand, leave to amend was in fact *granted* as to L-90, a secondary actor defendant below that is not a party to the Petition, which demonstrates that the standards articulated in the decision below are not insurmountable, as a matter of pleading, as Respondent would have this Court believe. More fundamentally, the mere fact that a secondary actor may *ultimately* prevail (on the merits or otherwise) in any given "scheme" case on the merits or otherwise, does not alter the practical reality that the decision below creates a portal for plaintiffs to bring and pursue, as Respondent has, a species of "aiding and abetting" claims against secondary actors that is at odds with Section 10(b) and *Central Bank*. Indeed, the mere existence of the Ninth Circuit's opinion has encouraged and will continue to authorize lower courts to allow these types of actions to survive the pleadings stage. *See, e.g.*, *Steiner v. MedQuist Inc.*, No. 04-5487, 2006 U.S. Dist. LEXIS 71952 (D.N.J. Sept. 29, 2006) (court relied on the Ninth Circuit's Purpose and Effects Test in denying motion to dismiss Section 10(b) claims based on a "scheme" theory of liability against individual defendants who were not alleged to have made any of the challenged misstatements or omissions). *See also In re Enron Corp. Securities Derivative & "ERISA" Litig.*, No. H-01-3624, 2006 U.S. Dist. LEXIS 43146, at *157-74 (S.D. Tex. June 7, 2006) (court rejected the District Court's

decision in *Homestore* (*see* Pet. App. at 32a-90a) and the Eighth Circuit's holding in *Charter* in finding that plaintiffs adequately alleged a "scheme" theory of liability under Section 10(b) against defendants who were not alleged to have made any of the challenged misstatements or omissions); Petition at 26-28 (citing cases denying motions to dismiss and allowing plaintiffs to proceed on "scheme" theories of liability). Particularly in the context of securities litigation, this risk of excessive, vexatious litigation alone warrants review of the decision below, even if a secondary actor might at some point prevail (no doubt after having to expend a significant amount of time and money) in actions filed as a result of the legally-defective standards articulated by the Ninth Circuit. *See e.g.*, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S. Ct. 1503, 1510-11 (2006) (discussing "the widespread recognition that 'litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general'") (citation omitted). (*See also* Petition at 28 (citing cases)).

CONCLUSION

The petition for a writ of *certiorari* should be granted.

Respectfully submitted,

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